DEPARTMENT OF THE TREASURY
EXCHANGE STABILIZATION FUND

Financial Report
Fiscal Year 2008

DEPARTMENT OF THE TREASURY
EXCHANGE STABILIZATION FUND

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The Nature and Function of the Exchange Stabilization Fund

The Gold Reserve Act of 1934 established a fund to be operated by the Secretary of the Treasury, with the approval of the President. Section 10 of the Act provided that "For the purpose of stabilizing the exchange value of the dollar, the Secretary of the Treasury, with the approval of the President, directly or through such agencies as he may designate, is authorized, for the account of the fund established in this section, to deal in gold and foreign exchange and such other instruments of credit and securities as he may deem necessary to carry out the purpose of this section." To this end, the Congress, in 1934, appropriated to the Exchange Stabilization Fund (ESF) the sum of $2 billion out of the increment resulting from the reduction in the "weight of the gold dollar." Subsequent amendments to the Gold Reserve Act approved the operation of the ESF through June 30, 1945. Section 7 of the Bretton Woods Agreements Acts, approved July 31, 1945, continued its operations permanently.

The Bretton Woods Agreements Act also directed the Secretary of the Treasury to pay $1.8 billion from the ESF to the International Monetary Fund (IMF), for the initial U. S. quota subscription in the IMF, thereby reducing the ESF's appropriated capital to $200 million.

Reflecting termination of the fixed exchange rate system, legislation enacted in 1976 (P.L. 94-564, effective April 1, 1978, the date of entry into force of the Second Amendment of the IMF Articles of Agreement) amended the language of Section 10 of the Gold Reserve Act to specify that the ESF is to be utilized as the Secretary "may deem necessary to and consistent with the United States obligations in the International Monetary Fund." In 1977, P.L. 95-147 further amended Section 10 of the Gold Reserve Act. Following codification, Section 10 now provides as follows:

> Consistent with the obligations of the Government in the International Monetary Fund on orderly exchange arrangements and a stable system of exchange rates, the Secretary or an agency designated by the Secretary, with the approval of the President, may deal in gold, foreign exchange, and other instruments of credit and securities the Secretary considers necessary. However, a loan or credit to a foreign entity or government of a foreign country may be made for more than 6 months in a 12-month period only if the President gives Congress a written statement that unique or emergency circumstances require the loan or credit be for more than 6 months (31 U.S.C. 5302 (b)).

Pursuant to the Special Drawing Rights Act of 1968 (P.L. 90-349, amended by P.L. 94-564, which was approved October 18, 1976 and became effective April 1, 1978), Special Drawing Rights (SDRs) allocated by the IMF to the United States or otherwise acquired by the United States are resources of the ESF.

Section 286p of Title 22 of the United States Code allows for SDRs to be monetized/demonetized through the issuance/redemption by the Secretary of the Treasury of SDR certificates to the Federal Reserve Banks in exchange for dollars. The total amount of SDR certificates outstanding cannot exceed the dollar equivalent of ESF (i.e., U. S.) holdings of SDRs; such certificates are a liability of the ESF.

I. Foreign Currency Operations

During fiscal year 2008, the ESF engaged in no market transactions.

a. Euros and Japanese Yen

The ESF had a net valuation gain of $532.4 million on its holdings of euros and yen. The ESF had investment income of $647.1 million equivalent on its euro and yen assets.

b. Mexico

In December 2007, the Treasury and Federal Reserve Bank of New York renewed the Exchange Stabilization Agreement with Mexico for another year to December 2008. On December 10, 2008, Treasury renewed its participation in the agreement until December 2010.

II. SDR Operations

As of September 30, 2008, U. S. holdings (assets) of SDRs totaled SDR 6.0 billion ($9.4 billion equivalent), a net increase of SDR 0.1 billion during Fiscal Year 2008. However, as the SDR appreciated against the dollar in this period, there was a net valuation gain of $0.3 million on U. S. holdings of SDRs. The ESF reimbursed the Treasury's General Fund $58.7 million for SDRs received from the IMF as remuneration on the U. S. reserve position in the IMF. The ESF earned interest of $301.8 million equivalent on its SDR holdings.

As of September 30, 2008, cumulative allocations to (liabilities of) the United States totaled SDR 4.9 billion ($7.6 billion equivalent). These liabilities would come due only in the event of liquidation of, or U. S. withdrawal from, the SDR Department of the IMF, or cancellation of SDRs.

There were $2.2 billion of SDR certificates that had been issued to the Federal Reserve System prior to Fiscal Year 2008 and remained outstanding at the end of the fiscal year.

III. Income and Expense

Interest revenue totaled $1,408 million, consisting of $459.3 million in interest on dollar holdings invested in U. S. Government securities, $301.8 million equivalent in interest on SDR holdings, and $647.1 million equivalent in interest on foreign currency investments.

Interest expense totaled $246.0 million, which included $245.9 million in interest charges on SDR Allocations and $0.1 million paid by the ESF to the Treasury General Fund on the dollar counterpart of SDRs received as remuneration on the U. S. reserve positioning the IMF.

IV. Temporary Guarantee Program for Money Market Mutual Funds

On September 19, 2008, the Secretary of the Treasury, with the approval of the President, established a temporary guarantee program for the U.S. money market mutual funds industry. Under the program the assets of the ESF will be available to guarantee the net asset value for shares of participating eligible money market funds. All publicly offered money market funds regulated under Rule 2a-7 of the Investment Company Act of 1940 and registered with the Securities and Exchange Commission that, as of September 19, 2008, had a policy of maintaining a stable net asset value of share price are eligible to participate, provided they pay a program participation fee beginning on September 29 and are accepted into the program by Treasury. The program has an initial term of three months, at which time the Secretary has the option to renew it up to the close of business on September 18, 2009, at which time participating funds would have to renew their participation at the extension point to maintain coverage. On November 24, 2008, the program was extended until April 30, 2009, at the discretion of the Secretary.

As of September 30, 2008, the ESF collected $39.7 million in insurance premiums. As of October 10, 2008, the ESF collected an additional $298.1 million in insurance premiums. These premiums represent the payments for the first three initial months of coverage which began September 19, 2008. Of the total $337.8 million collected, $45.0 million was recognized as earned revenue, while $292.8 remained as unearned revenue.

V. On November 19, 2008, Treasury entered into a transaction with the Reserve Fund's U.S. Government Fund (USGF), under which Treasury (1) executed the Guarantee Agreement which accepted the USGF into the Treasury Guarantee Program (see Note 7) and (2) signed a Letter Agreement with the USGF. Under the terms of the Letter Agreement, Treasury was obligated to purchase in early January the USGF’s remaining securities issued by four U.S. government sponsored enterprises. On January 15, 2009, the ESF purchased approximately $3.6 billion of these securities; the purchase price representing the amortized cost of the remaining securities, plus accrued but unpaid interest. Upon consummation of the purchase, these GSE securities were classified as held to maturity and will be reported as investment securities as of the date of purchase.

KPMG LLP
2001 M Street, NW
Washington, DC 20036

Independent Auditors' Report

Inspector General
U.S. Department of the Treasury:

We have audited the accompanying statement of financial position of the U.S. Department of the Treasury's (Department) Exchange Stabilization Fund (ESF) as of September 30, 2008, and the related statement of income and retained earnings, and statement of cash flows (hereinafter referred to as financial statements) for the year then ended. These financial statements are the responsibility of the ESF's management. Our responsibility is to express an opinion on these financial statements based on our audit. The accompanying fiscal year 2007 financial statements were audited by other auditors, whose report thereon dated November 9, 2007, expressed an unqualified opinion on these financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the ESF's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the ESF as of September 30, 2008, and the results of its operations and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

In September 2008, the Department established a Temporary Guarantee Program for Money Market Funds (Treasury Guarantee Program). Use of the ESF's assets to support the Treasury Guarantee Program was approved by the President and the Secretary of the Treasury on September 19, 2008. See Notes 7, 8, and 9.

Our audit was conducted for the purpose of forming an opinion on the financial statements taken as a whole. The information in the Policy and Operations Statements section, on pages 2 through 4 is presented for purposes of additional analysis and is not required as part of the financial statements. This information has not been subjected to auditing procedures and, accordingly, we express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our reports dated February 13, 2009, on our consideration of the ESF's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in assessing the results of our audit.

KPMG LLP

February 13, 2009

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Independent Auditors' Report on Internal Control Over Financial Reporting

Inspector General
U.S. Department of the Treasury:

We have audited the accompanying statement of financial position of the U.S. Department of the Treasury's (Department) Exchange Stabilization Fund (ESF) as of September 30, 2008, and the related statement of income and retained earnings, and statement of cash flows (hereinafter referred to as financial statements) for the year then ended, and have issued our report thereon dated February 13, 2009.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

The management of the ESF is responsible for establishing and maintaining effective internal control. In planning and performing our fiscal year 2008 audit, we considered the ESF's internal control over financial reporting by obtaining an understanding of the design effectiveness of ESF's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements. To achieve this purpose, we did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*. The objective of our audit was not to express an opinion on the effectiveness of the ESF's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the ESF's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the internal control over financial reporting that might be significant deficiencies or material weaknesses.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the ESF's ability to initiate, authorize, record, process, or report financial data reliably in accordance with U.S. generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the ESF's financial statements that is more than inconsequential will not be prevented or detected by the ESF's internal control. A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the ESF's internal control.

In our fiscal year 2008 audit, we consider the deficiencies, described below, to be significant deficiencies in internal control over financial reporting. The significant deficiency related to foreign currency investment transactions noted below is considered to be a material weakness for the ESF.

MATERIAL WEAKNESS

Foreign Currency Investment Transactions

Improvements are needed in internal controls over accounting and reporting related to ESF's foreign currency investments. ESF's foreign currency operations are conducted on its behalf by a designated fiscal agent. Foreign currency functions conducted by the fiscal agent include management of ESF's foreign currency portfolio in accordance with Treasury stipulated guidelines, execution of purchases/sales of foreign currency in the market, purchases and sales of foreign currency in non-market transactions, and other foreign currency transactions as directed by the Secretary of the Treasury. In addition, the fiscal agent is responsible for the monthly accounting and reporting to the ESF of foreign currency activities. The fiscal agent also provides the data that supports various ESF financial statement disclosures such as that for fair values.

The ESF relies entirely on the financial information reported by the fiscal agent and incorporates the financial data reported monthly into ESF's general ledger and financial statements. Although ESF's financial data is subject to detailed review and validation by the fiscal agent, ESF has no corresponding internal monitoring procedures and controls in place to substantiate the accuracy of the transactions/balances reported by the fiscal agent. Several control deficiencies were noted, as described below, that indicated a weak control environment, resulting in financial management and reporting weaknesses.

- Foreign currency transaction details are not recorded at the transaction level in ESF's general ledger. Only the net monthly changes in foreign currency account balances are recorded in ESF's general ledger, causing ESF to rely entirely on the fiscal agent for any details needed for financial reporting.

- There are no procedures to monitor the completeness of the foreign currency balances reported by the fiscal agent. Comprehensive internal processes, procedures, and controls over foreign exchange transactions are essential to ensure that the foreign currency transactions and balances reported by the fiscal agent are complete and accurate, and reported appropriately in the ESF's financial statements.

- There are no policies, procedures, and related internal controls to test whether foreign currency transactions reported by the fiscal agent are valid and supported by appropriate source documentation. ESF relies on the fiscal agent to provide the needed functional and accounting support, and has not designed and implemented the procedures and controls necessary to independently verify the reliability of financial reporting by the fiscal agent. Implementation of appropriate procedures and controls over investment transactions and balances reported by the fiscal agent is needed to minimize the risk of fraud, undetected errors, and mismanagement of funds, which could ultimately lead to financial statement misstatements.

- ESF has no policies, procedures, and internal controls to compile, support (to include valid support for the preparation of all disclosures), review, and report financial statement amounts and related disclosures related to foreign currency investments.

- Although there is reliance on the fiscal agent for the monthly accounting and reporting of foreign currency activities, ESF has no procedures to conduct periodic (at least annually) site visits to the fiscal agent to review and test the fiscal agent's procedures and control activities.

- ESF does not have sufficient staff to expeditiously address routine and non-routine accounting issues.

The Federal Managers' Financial Integrity Act of 1982 (FMFIA) requires that agencies establish internal controls according to standards prescribed by the Comptroller General and specified in the *GAO Standards for Internal Control in the Federal Government (GAO Standards)*. These standards define internal control as an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved: effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations. *GAO Standards* state that internal controls should generally be designed to assure that on-going monitoring occurs in the course of normal operations. Management is responsible for developing control activities, which are the policies, procedures, techniques, and mechanisms that enforce management's directives and help ensure actions address risks. The activities include reviews by management at the functional or activity level, proper execution of transactions and events, accurate and timely recording of transactions and events, and appropriate documentation of transactions and internal control.

Recommendations

We recommend that ESF's Chief Executive Officer and Chief Financial Officer:

1. Conduct an evaluation of the current financial reporting processes over foreign currency transactions, including a review of ESF's general ledger system, with the goal of establishing a general ledger that captures investment activity at the transaction level, i.e. all financial transactions are recorded in the general ledger at the detailed transaction level as they occur;
2. Establish a formal independent recalculation and review process over all foreign currency reconciliation activities to be performed by ESF staff in order to ensure that all foreign currency transactions and balances reported by the fiscal agent are complete and accurate. This involves independently computing ending general ledger balances and comparing to transactions and balances reported by the fiscal agent;
3. Establish policies, procedures, and related internal controls to ensure that the foreign currency transactions reported by the fiscal agent are supported by appropriate source documentation. Selected foreign currency transactions should be agreed to supporting documentation, tested for accuracy, evidence of fiscal agent's management review and approval, and appropriateness of accounting and reporting;
4. Develop and implement policies, procedures, and internal controls to compile, support (to include valid support for the preparation of all disclosures), review, and report foreign currency financial statement amounts and related disclosures;
5. Conduct periodic (at least annually) site visits to the fiscal agent to review and test their procedures and control activities. These reviews should be thorough, comprehensive, and include robust testing. Such activities should be documented and any issues followed up and resolved timely; and
6. Perform a human capital needs assessment, with particular focus on ESF staff management skills needed to perform the daily financial operations of ESF. Once the human capital needs are assessed, hire staff, or consider transferring suitable staff from other offices within Treasury to meet these needs.

SIGNIFICANT DEFICIENCY

Temporary Money Market Insurance Program

Improvements are needed in financial management and reporting practices due to expanded accounting and reporting requirements, and responsibilities resulting from the establishment of the Temporary Guarantee Program for Money Market Funds (Treasury Guarantee Program). ESF overcame significant time and personnel resource constraints to execute, manage, and report the activities of the Treasury Guarantee Program all of which occurred during the last month of the fiscal year. These transactions were processed in a shortened time-frame leading to various control deficiencies. ESF did not properly formulate the accounting policies and procedures needed to account and report these non-routine transactions. During our review of these transactions, we noted several discrepancies that were only corrected after they were identified during audit test work. Also, supervisory and other monitoring procedures were not timely and consistently performed over financial data and other information submitted for audit.

The *GAO Standards* state that internal controls should generally be designed to assure that on-going monitoring occurs in the course of normal operations. Management is responsible for developing control activities, which are the policies, procedures, techniques, and mechanisms that enforce management's directives and help ensure actions address risks. The control activities include reviews by management at the functional or activity level, proper execution of transactions and events, accurate and timely recording of transactions and events, and appropriate documentation of transactions and internal control.

Recommendation

We recommend that ESF's Chief Executive Officer, and Chief Financial Officer develop and establish the appropriate policies, procedures, and controls needed to adequately support the accounting and reporting requirements for the transactions resulting from the Treasury Guarantee Program.

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ESF management's response to the findings identified in our audit is presented in Exhibit I. We did not audit management's response and, accordingly, we express no opinion on it.

We noted one additional matter that we have reported to management of the ESF in a separate letter dated February 13, 2009.

This report is intended solely for the information and use of the ESF's management, the Department's Office of Inspector General, OMB, the U.S. Government Accountability Office, and the U.S. Congress and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

February 13, 2009

Exhibit 1 – Management's Responses

MATERIAL WEAKNESS

Foreign Currency Investment Transactions

While ESF Management largely concurs with the recommendations, we disagree with the underlying finding. The internal controls the auditors found to be a "material weakness" are the same controls ESF's prior external auditor found sufficient since Fiscal Year 2004. There was no indication, or any determination, from our previous auditors that internal controls over financial accounting were ineffective. In addition, Treasury's Office of the Inspector General (OIG) performed the audit prior to Fiscal Year 2004 and never raised any questions about internal controls over financial accounting, either then or, in the OIG oversight role, in subsequent years.

ESF's Management relied on these prior audits and believed proper internal controls were in place and laws and regulations were followed. We believe, therefore, that it would be more appropriate for KPMG to issue management letter recommendations instead of this late determination that there is a material weakness.

ESF will follow the highest standards of internal control and will work to establish the controls over financial reporting recommended in this report. However, ESF Management does not agree with the finding of a material weakness. Based on prior audits and the oversight of the Treasury OIG, we believed internal controls were sufficient and in accordance with FMFIA. ESF Management requests the finding be changed to a management letter recommendation.

Management's Response to Recommendation 1:
We agree in principle with the recommendation but, at the current time, ESF is unable to record transactions at the detailed transaction level. ESF engages in a very large number of transactions and recording each transaction would be a manual process and involve a significant increase in staffing. The effort would also duplicate the work performed by the Federal Reserve Bank of New York (FRBNY). ESF will make the following changes in its procedures to address this recommendation. Entries will be summarized on a weekly basis, a more thorough review will be performed by management, and transactions will be sampled to ensure their accuracy. The Office of Financial Management (OFM) staff will also work with FRBNY to develop a systematic, automated approach for capturing detailed financial transactions in the general ledger.

Management's Response to Recommendation 2:
We concur with the recommendation that a formal independent recalculation and review process of all FCDA's be accomplished by our staff to ensure that transactions and balances as reported by the fiscal agent are complete and accurate. Immediately after the auditors communicated this recommendation, OFM immediately put processes in place to request reconciliations from the international banks on a monthly basis. In turn, sampling of weekly transactions will be accomplished to verify various securities held, exchange rate calculations, and reconciling balances.

Management's Response to Recommendation 3:
We concur with the recommendation and, as Recommendations 1 and 2 are implemented, OFM will develop new policies, procedures and related internal controls to satisfy the requirement for

FMFIA. Our ultimate goal is to ensure the highest standards of internal control over financial reporting are established and followed, according to the laws and regulations of FMFIA.

Management's Response to Recommendation 4:
We concur with the recommendation and will develop and implement policies, procedures and internal controls for reporting ESF activity. We will document these as we update current procedures to address Recommendation 3.

Management's Response to Recommendation 5:
We concur with the recommendation and have been in contact with the fiscal agent to make arrangements for periodic visits. Currently, we plan to visit FRBNY annually prior to June 30 reporting. All visits will be documented and we will resolve issues in a timely manner.

Management's Response to Recommendation 6:
The Office of Financial Management regularly assesses staff management skills and works to ensure managerial skills and knowledge are sufficient to perform the daily activities of the ESF. We are confident the ESF staff has the necessary knowledge and management skills to strengthen the financial accounting and reporting infrastructure and effectively manage the process. We will continually reassess the ESF's human capital needs.

We agree the addition of skilled staff would bolster ESF reporting. The ESF statute, however, prohibits the payment of administrative costs by ESF and there is no funding mechanism for additional staff outside of the Departmental Offices Salaries and Expenses (S&E) appropriation. Competing priorities in the S&E appropriation (such as funding the effort to combat financial terrorism) make the availability of additional S&E resources for ESF unlikely. We believe, however, we can address your recommendations, without the addition of staff, with improved internal controls and business processes for financial reporting.

SIGNIFICANT DEFICIENCY

Temporary Money Market Insurance Program

Pursuant to the Secretary's authorization, the Office of the Assistant Secretary for Domestic Finance has been designated as the managers for this new program. ESF Management will work with this office to establish new policies and procedures to require documentation that supports all the new and/or unique accounting and reporting requirements for this Program.

KPMG LLP
2001 M Street, NW
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Independent Auditors' Report on Compliance and Other Matters

Inspector General
U.S. Department of the Treasury:

We have audited the accompanying statement of financial position of the U.S. Department of the Treasury's (Department) Exchange Stabilization Fund (ESF) as of September 30, 2008, and the related statement of income and retained earnings, and statement of cash flows (hereinafter referred to as financial statements) for the year then ended, and have issued our report thereon dated February 13, 2009.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

The management of the ESF is responsible for complying with laws, regulations, and contracts applicable to the ESF. As part of obtaining reasonable assurance about whether the ESF's financial statements are free of material misstatement, we performed tests of the ESF's compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of the financial statement amounts. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws, regulations, and contracts, applicable to the ESF. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our tests of compliance described in the preceding paragraph of this report, disclosed no instances of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 07-04.

This report is intended solely for the information and use of the ESF's management, the Department's Office of Inspector General, OMB, the U.S. Government Accountability Office, and the U.S. Congress and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

February 13, 2009

DEPARTMENT OF THE TREASURY
EXCHANGE STABILIZATION FUND
STATEMENTS OF FINANCIAL POSITION
(In Thousands)

As of September 30	**2008**	**2007**
Assets		
Cash and Cash Equivalents (Note 2):		
Fund Balance with Treasury	$ 33,150	$ -
U.S. Government Securities	16,846,844	16,436,114
Foreign Currency Denominated Assets	9,257,093	7,599,522
Total Cash and Cash Equivalents	26,137,087	24,035,636
Other Foreign Currency Denominated Assets (Note 3)	3,474,221	4,445,254
Special Drawing Right Holdings (Note 4)	9,417,541	9,300,550
Investment Securities (Note 5)	10,417,505	9,918,457
Interest Receivable (Notes 2, 3, and 5)	152,092	161,790
Interest Receivable on Special Drawing Right Holdings	45,912	62,563
Insurance Premiums Receivable (Note 7)	298,147	-
Total Assets	$ 49,942,505	$ 47,924,250
Liabilities and Equity		
Liabilities:		
Certificates Issued to Federal Reserve Banks (Note 6)	$ 2,200,000	$ 2,200,000
Special Drawing Right Allocations (Note 4)	7,629,646	7,626,853
Interest Payable on Special Drawing Right Allocations	37,196	51,305
Deferred Insurance Premium Revenue (Note 7)	292,800	-
Other	232	149
Total Liabilities	10,159,874	9,878,307
Commitments and Contingencies (Notes 7, 8 and 9)		
Equity:		
Appropriated Capital (Note 1A)	200,000	200,000
Retained Earnings	39,582,631	37,845,943
Total Equity	39,782,631	38,045,943
Total Liabilities and Equity	$ 49,942,505	$ 47,924,250

See accompanying notes to financial statements.

DEPARTMENT OF THE TREASURY
EXCHANGE STABILIZATION FUND
STATEMENTS OF INCOME AND RETAINED EARNINGS
(In Thousands)

Years Ended September 30	**2008**	**2007**
Interest Income		
Interest on U.S. Government Securities	$ 459,348	$ 834,219
Interest on Foreign Currency - Denominated Assets	424,096	329,551
Interest on Special Drawing Right Holdings (Note 4)	301,826	370,916
Interest on Investment Securities	223,040	171,600
Total Interest Income	1,408,310	1,706,286
Interest Expense		
Interest on Special Drawing Right Allocations (Note 4)	(245,884)	(306,583)
Interest on Special Drawing Right - Remuneration due to the U.S. Treasury	(100)	(518)
Total Interest Expense	(245,984)	(307,101)
Net Interest Income	1,162,326	1,399,185
Net Gains (Losses)		
Gain (Loss) on Valuation of:		
Special Drawing Rights, net	(2,418)	83,620
Investment Securities and - Foreign Currency Denominated Assets, net (Notes 3 and 5)	532,397	1,678,690
Total Net Gains	529,979	1,762,310
Other Income		
Insurance Premiums (Note 7)	45,045	-
Total Income	1,737,350	3,161,495
Other Expenses		
International Monetary Fund Annual Assessment	(662)	(342)
Net Income	1,736,688	3,161,153
Retained Earnings, Beginning of Year	37,845,943	34,684,790
Retained Earnings, End of Year	$ 39,582,631	$ 37,845,943

See accompanying notes to financial statements.

DEPARTMENT OF THE TREASURY
EXCHANGE STABILIZATION FUND
STATEMENTS OF CASH FLOWS
(In Thousands)

Years Ended September 30	**2008**	**2007**
Cash Flows from Operating Activities:		
Interest Received on:		
U.S. Government Securities	$ 462,991	$ 832,771
Foreign Currency Denominated Assets	312,616	317,243
Investment Securities	349,017	146,156
Insurance Premiums	39,693	-
Other	(9,117)	9,096
Net Cash Provided by Operating Activities	1,155,200	1,305,266
Cash Flows from Investing Activities:		
Net Purchases/Sales of Foreign Currency Denominated Assets	968,011	(384,575)
Net Increase in Investment Securities	(68,639)	(25,559)
Reimbursement for Remuneration Received (Note 4)	(58,704)	(107,701)
Other	574	-
Net Cash Provided by (Used in) Investing Activities	841,242	(517,835)
Effect of Exchange Rate on Cash	105,009	727,448
Net Increase in Cash and Cash Equivalents	2,101,451	1,514,879
Cash and Cash Equivalents, Beginning of Year	24,035,636	22,520,757
Cash and Cash Equivalents, End of Year	$ 26,137,087	$ 24,035,636
Reconciliation of Net Income to Net Cash Provided by Operating Activities		
Net Income	$ 1,736,688	$ 3,161,153
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Net Exchange Rate Gain on FCDAs and Investment Securities	(532,397)	(1,678,690)
Increase in Special Drawing Right Holdings Due to Valuation	(282)	(476,567)
Net Increase in Special Drawing Rights Holdings	(58,577)	(61,772)
Decrease (Increase) in Accrued Interest Receivable	26,348	(36,717)
Increase in Insurance Premium Receivable	(298,147)	-
Increase in Special Drawing Right Allocations Due to Valuation	2,793	393,334
(Decrease) Increase in Accrued Expenses and Other	(14,026)	4,525
Increase in Deferred Insurance Premium Revenue	292,800	-
Total Adjustments	(581,488)	(1,855,887)
Net Cash Provided by Operating Activities	$ 1,155,200	$ 1,305,266

See accompanying notes to financial statements.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Entity

The Gold Reserve Act of 1934 (the Act) established a fund to be operated by the Secretary of the Treasury, with the approval of the President. Section 10(a) of the Act originally provided that "For the purpose of stabilizing the exchange value of the dollar, the Secretary of the Treasury, with the approval of the President, directly or through such agencies as he may designate, is authorized, for the account of the fund established in this section, to deal in gold and foreign exchange and such other instruments of credit and securities as he may deem necessary to carry out the purpose of this section." To this end, the Congress, in 1934, appropriated to the Exchange Stabilization Fund (ESF) the sum of $2 billion out of the increment resulting from the reduction in the "weight of the gold dollar." Subsequent amendments to the Gold Reserve Act approved the operation of the ESF through June 30, 1945. Section 7 of the Bretton Woods Agreements Acts, approved July 31, 1945, continued its operations permanently. The Bretton Woods Agreements Act also directed the Secretary of the Treasury to pay $1.8 billion from the ESF to the International Monetary Fund (IMF), for the initial U.S. quota subscription in the IMF, thereby reducing the ESF's appropriated capital to $200 million. Section 10(b) of the Act, as amended, 31 U.S.C. 5302(b) now provides in relevant part: "Consistent with the obligations of the Government in the International Monetary Fund on orderly exchange arrangements and a stable system of exchange rates, the Secretary or an agency designated by the Secretary, with the approval of the President, may deal in gold, foreign exchange, and other instruments of credit and securities the Secretary considers necessary."

The Federal Reserve Bank of New York (FRBNY) acts as the fiscal agent for the ESF, as permitted by the Federal Reserve Act. As the fiscal agent, the FRBNY plays a significant role in the processing of foreign currency transactions that the Secretary of the Treasury authorizes. The manager of the ESF foreign currency portfolio at the FRBNY consults regularly with the Federal Open Market Committee and the U.S. Department of the Treasury (Department/Treasury) about the disposition of investments and the status of the portfolio. The level and currency composition of the ESF foreign currency portfolio are the products of policy determinations. The ESF management is responsible for the record keeping and investment decisions for foreign currency transactions managed by the FRBNY.

As provided in section 10(a)(1) of the Act, 31 USC 5302(a)(1), the ESF is "not available to pay administrative expenses." Treasury's Office of International Affairs has responsibility for managing ESF operations, and Treasury's Office of Financial Management provides the recordkeeping and financial reporting services for the ESF. These Treasury offices bear all administrative expenses of the ESF. Accordingly, there are no administrative expenses reported in the financial statements.

B. Basis of Accounting and Presentation

The ESF has historically prepared its financial statements in accordance with generally accepted accounting principles, based on accounting standards issued by the Financial Accounting Standards Board (FASB), the private-sector standards-setting body. The Federal Accounting Standards Advisory Board (FASAB) was designated by the American Institute of Certified Public Accountants (AICPA) as the standards-setting body for financial statements of federal government entities, with respect to the establishment of generally accepted accounting principles. FASAB has indicated, however, that financial statements prepared based upon accounting standards published by the FASB may also be regarded as in accordance with generally accepted accounting principles for those federal entities, such as the ESF, that

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

have issued financial statements based upon FASB accounting standards in the past. Accordingly, consistent with historical reporting, the ESF financial statements are presented in accordance with accounting standards published by the FASB.

C. Use of Estimates

In accordance with generally accepted accounting principles, the preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates used in the preparation of the financial statements and footnotes relate to investments, and the contingent liability. Actual results could differ from those estimates.

D. Fair Values of Financial Instruments

Statement of Financial Accounting Standards (SFAS) No. 107, *Disclosure about Fair Value of Financial Instruments*, requires all entities to disclose the fair value of financial instruments, where feasible, in an effort to provide financial statement users with information in making rational investment and credit decisions.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which will be effective for an entity's financial statements issued for fiscal years beginning after November 15, 2007. SFAS No. 157 provides enhanced guidance on the definition of fair value, the methods to measure fair value and the expanded disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measures. The ESF is currently evaluating the implications of SFAS No. 157.

To estimate the fair value of each class of financial instrument, the ESF applied the following methods using the indicated assumptions:

Cash and Cash Equivalents
Cash and Cash Equivalents consist of U.S. government securities and Foreign Currency Denominated Assets (FCDAs), and are reported in the statements of financial position at amounts that approximate their fair values.

Special Drawing Right (SDR) Holdings and SDR Allocations
Using current exchange rates, these amounts have been revalued in the statements of financial position to amounts that approximate fair value.

Investment Securities and Other FCDAs
The fair value of investment securities and other FCDAs are based upon quoted market and current exchange rates.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

E. Certificates Issued to Federal Reserve Banks

Certificates issued to Federal Reserve Banks (FRB) are reflected on the statements of financial position at their face value. It is not practicable to estimate the fair value of these certificates issued to FRBs since these certificates contain no specific terms of repayment and have no market.

F. Foreign Currency Denominated Assets

Foreign Currency Denominated Assets (FCDA) include interest-bearing foreign deposit accounts and investments in foreign government securities. In accordance with SFAS No. 52, *Foreign Currency Translation*, FCDAs are revalued to reflect current exchange rates in effect as of the reporting date. The gains or losses resulting from changes in exchange rates are recognized separately in the statements of income and retained earnings.

G. U.S. Government Securities

The ESF invests dollars in excess of its immediate needs in overnight, nonmarketable U.S. government securities issued by the Treasury. The interest rate paid on the investments is the overnight repurchase agreement rate as established by the Treasury's Bureau of Public Debt.

H. Reclassifications

Certain reclassifications have been made to prior year amounts reported in the statements of cash flows to conform to the current year presentation.

I. Tax-Exempt Status

As a component of the Treasury, which is a federal agency, the ESF is not subject to federal, state, or local income taxes, and accordingly, no provision for income taxes is recorded.

NOTE 2 – CASH AND CASH EQUIVALENTS

Cash equivalents are short-term, highly liquid investments that are both readily convertible to known amounts of cash, and so near their maturity that they present insignificant risk of change in value due to changes in interest rates. Generally, only investments with original maturities of three months or less qualify under that definition. U.S. government securities, repurchase agreements, and FCDAs with original maturities of three months or less are treated as cash equivalents.

The ESF invests a portion of its FCDA Euro holdings through repurchase agreements in securities issued by, and backed by the full faith and credit of, the governments of Belgium, France, Germany, Italy, the Netherlands, and Spain. The amounts of these repurchase agreements included at year-end amounted to \$3.7 billion and \$2.5 billion out of a total of \$9.3 billion and \$7.6 billion as of September 30, 2008 and 2007, respectively. These are considered to be FCDAs with original maturities generally of one week or less, which are treated as cash equivalents, as discussed above.

NOTE 2 – CASH AND CASH EQUIVALENTS (CONTINUED)

Cash and cash equivalent amounts held as of September 30, 2008 and 2007 are as follows:

September 30 (In Thousands)	2008	2007
Cash and cash equivalents:		
Fund balance with Treasury	$ 33,150	$ -
U. S. government securities	16,846,844	16,436,114
FCDAs:		
European euro	6,148,351	4,871,893
Japanese yen	3,108,742	2,727,629
Total FCDAs	9,257,093	7,599,522
Total cash and cash equivalents	$ 26,137,087	$ 24,035,636

NOTE 3 – OTHER FCDAs

Other FCDAs include foreign currency holdings with maturities greater than three months as follows:

September 30 (In Thousands)	2008	2007
At cost:		
European euro	$ 3,474,221	$ 4,445,254
At fair value:		
European euro	$ 3,498,166	$ 4,477,010

NOTE 4 – SPECIAL DRAWING RIGHTS

The Special Drawing Rights (SDR) is an international reserve asset (capital held back from investment in order to meet probable or possible demands) created by the International Monetary Fund (IMF). It was created as a supplement to existing reserve assets, and on several occasions SDRs have been allocated by the IMF to members participating in the IMF's SDR Department. A reserve asset derives its value from the commitments of participants to hold and accept SDRs and to honor various obligations connected with its proper functioning as a reserve asset.

(Continued)

NOTE 4 – SPECIAL DRAWING RIGHTS (CONTINUED)

The IMF calculates the value of the SDR using the market value, in terms of the U.S. dollar, of each of the four freely usable weighted currencies, as defined by the IMF. These currencies are the U.S. dollar, the European euro (components consist of the French and German weights), the Japanese yen, and the pound sterling. The ESF's SDR Allocations and Holdings (see below) are revalued monthly based on the SDR valuation rate calculated by the IMF, and an unrealized gain or loss on revaluation is recognized. SDR Holdings and SDR Allocations are reported as an asset and liability respectively in the financial statements of the ESF.

SDR Allocations

Pursuant to the Special Drawing Rights Act of 1968, as amended, SDRs allocated by the IMF to, or otherwise acquired by the United States are resources of ESF. SDRs, once allocated, are permanent resources unless:

a. They are canceled by an 85 percent majority decision of the total voting power of the Board of Governors of the IMF;

b. The SDR Department of the IMF is liquidated;

c. The IMF is liquidated; or

d. The United States chooses to withdraw from the IMF or terminate its participation in the SDR Department.

Except for the payment of interest and charges on SDR allocations to the United States, the payment of the ESF's liability related to the SDR allocations is conditional on events listed above, in which the United States has a substantial or controlling voice. Allocations of SDRs were made on January 1, 1970, 1971, 1972, 1979, 1980, and 1981. Since 1981, the IMF has made no further allocations of SDRs. As of September 30, 2008 and 2007, the value of SDR allocations was the equivalent of $7.6 billion for each year.

SDR Holdings

SDR Holdings represent transactions resulting from the ESF's SDR activities that are primarily the result of IMF allocations. Other transactions reported in this account are recorded as they are incurred and include any SDR acquisitions and sales, interest received on SDR Holdings, interest charges on SDR Allocations, and other SDR related activities (see below), as well as valuation adjustments.

NOTE 4 – SPECIAL DRAWING RIGHTS (CONTINUED)

The following schedule reflects the actual activity related to SDR Holdings during fiscal years 2008 and 2007 in SDR and dollar equivalent.

September 30 (SDR In Thousands)	**2008**	**2007**
Beginning balance	5,974,721	5,862,021
Interest received on holdings	199,394	243,177
Interest paid on allocations	(162,789)	(201,624)
Remuneration	36,685	71,385
IMF annual assessment	(348)	(238)
Net gain on valuation of holdings	-	-
Total SDR - Holdings	6,047,663	5,974,721

September 30 (Dollar Equivalent In Thousands)	**2008**	**2007**
Beginning balance	$ 9,300,550	$ 8,654,510
Interest received on holdings*	319,025	366,490
Interest paid on allocations*	(260,448)	(303,843)
Remuneration	58,704	107,183
IMF annual assessment	(572)	(357)
Net gain on valuation of holdings	282	476,567
Total Dollar Equivalent – Holdings	$ 9,417,541	$ 9,300,550

* Includes net valuation adjustments. Valuation adjustments applicable to interest received on holdings amounted to a net unrealized gain of $548,000 and $2,188,000 respectively, for fiscal years 2008 and 2007. Valuation adjustments applicable to interest paid on allocations amounted to a net unrealized loss of $455,000 and $1,800,000 respectively, for fiscal years 2008 and 2007.

Other SDR Activities

The U. S. Government receives remuneration in SDRs from the International Monetary Fund (IMF) on the U.S. claim on the IMF, represented by the U.S. Reserve Position. The ESF is the only agency within Treasury permitted to transact in SDRs. SDRs received become the resources of the ESF, as required under 22 USC 286o, and the ESF pays the dollar equivalent to the U. S. Government’s Treasury General Account (TGA). The ESF's receipt of the SDRs and payment of the dollar equivalent to the TGA are not simultaneous. Typically, the payment is several weeks after the receipt of SDRs from the IMF. Therefore, the ESF must reimburse the TGA the interest it earned on those dollars during the period, which elapsed between the receipt of the SDRs and the dollar payment to the TGA.

(Continued)

NOTE 4 – SPECIAL DRAWING RIGHTS (CONTINUED)

The ESF paid to the TGA $100,000 and $500,000 in fiscal years 2008 and 2007, respectively, in interest due on the transferred dollars. The ESF did not sell or purchase SDRs from participating members during fiscal year 2008 or 2007.

NOTE 5 – INVESTMENTS AND RELATED INTEREST

In accordance with SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, securities that the ESF has both the positive intent and ability to hold to maturity are classified as investment securities held to maturity and carried at historical cost, adjusted for amortization of premiums and accretion of discounts. Interest on investment securities, amortization of premiums, and accretion of discounts are reported in interest on investment securities and are recognized on an accrual basis. The following schedule reflects government investment securities at their amortized cost and by year of maturity as of September 30, 2008 and 2007. There are no securities maturing after ten years.

September 30 (In Thousands)	2008	2007
All Securities (at Amortized Cost)		
German bonds	$ 1,928,650	$ 2,129,248
French bonds	1,182,557	1,134,770
French notes	1,395,099	1,125,937
Japanese bonds	5,911,199	5,528,502
Total amortized cost	$ 10,417,505	$ 9,918,457
Maturing Within 1 Year		
Fair Value:		
German bonds	$ 367,931	$ 306,155
French bonds	309,248	395,687
French notes	193,602	102,896
Japanese bonds	2,596,008	2,418,534
Total fair value	$ 3,466,789	$ 3,223,272
Amortized cost:		
German bonds	$ 358,883	$ 300,135
French bonds	296,349	380,442
French notes	192,197	102,761
Japanese bonds	2,589,426	2,414,804
Total amortized cost	$ 3,436,855	$ 3,198,142

(Continued)

NOTE 5 – INVESTMENTS AND RELATED INTEREST (CONTINUED)

September 30 (In Thousands)	**2008**	**2007**
Unrealized net gain:		
German bonds	$ 9,048	$ 6,020
French bonds	12,899	15,245
French notes	1,405	135
Japanese bonds	6,582	3,730
Total unrealized net gain as of September 30	$ 29,934	$ 25,130
Maturing after 1 Year through 5 Years		
Fair value:		
German bonds	$ 1,627,951	$ 1,862,191
French bonds	916,115	772,112
French notes	1,226,271	1,022,718
Japanese bonds	3,338,856	3,119,780
Total fair value	$ 7,109,193	$ 6,776,801
Amortized cost:		
German bonds	$ 1,569,767	$ 1,829,113
French bonds	886,208	754,328
French notes	1,202,902	1,023,176
Japanese bonds	3,321,773	3,113,698
Total amortized cost	$ 6,980,650	$ 6,720,315
Unrealized net gain/(loss):		
German bonds	$ 58,184	$ 33,078
French bonds	29,907	17,784
French notes	23,369	(458)
Japanese bonds	17,083	6,082
Total unrealized net gain as of September 30	$ 128,543	$ 56,486

(Continued)

NOTE 6 – CERTIFICATES ISSUED TO FEDERAL RESERVE BANKS

The Special Drawing Right Act of 1968 authorized the Secretary of the Treasury to issue certificates, not to exceed the value of SDR holdings, to the Federal Reserve System in return for interest-free dollar amounts equal to the face value of certificates issued (SDR monetization). The certificates may be issued for the purpose of financing the acquisition of SDRs from other countries or to provide resources for financing other operations of the ESF. Certificates issued are to be redeemed by the ESF at such times and in such amounts as the Secretary of the Treasury may determine (SDR demonetization). There were no SDR monetizations or demonetizations transacted during fiscal years 2008 and 2007. As of September 30, 2008 and 2007, the amount of certificates issued to Federal Reserve Banks was $2.2 billion.

NOTE 7 – TEMPORARY GUARANTEE PROGRAM FOR MONEY MARKET FUNDS

The Treasury established a Temporary Guarantee Program for Money Market Funds (Treasury Guarantee Program) in September 2008, which is managed under the purview of the Treasury Assistant Secretary for Financial Institutions. Under the Treasury Guarantee Program, the Treasury guarantees that investors will receive the stable share price (SSP) for each share held in a participating money market fund up to the number of shares held as of the close of business as of September 19, 2008. Use of ESF's assets to support the Treasury Guarantee Program was approved by the President and the Secretary of the Treasury on September 19, 2008 and the Treasury Guarantee Program opened for participation on September 29, 2008.

Eligible funds must be regulated under Rule 2a-7 of the Investment Company Act of 1940, such funds must maintain a SSP, must have had a market-based net asset value (NAV) of at least 99.5 percent of the SSP as of September 19, 2008, and must be publicly offered and registered with the Securities and Exchange Commission. The initial Treasury Guarantee Program was in effect until December 18, 2008, and on November 24, 2008, was extended until April 30, 2009 by the Secretary of the Treasury.

To participate in the initial Treasury Guarantee Program, eligible money market funds had to submit an application and pay a premium of 1 basis point, based on the number of shares outstanding on September 19, 2008, if the fund's NAV was greater than or equal to 99.75 percent of the SSP, or 1.5 basis points, based on the number of shares outstanding on that date, if the SSP if the fund's NAV was less than 99.75 percent of the SSP but greater than or equal to 99.50 percent of the SSP.

As of September 30, 2008, the ESF collected $39.7 million in program participation payments. As of October 10, 2008, which corresponds to the initial Treasury Guarantee Program application deadline, the ESF collected an additional $298.1 million in program participation payments. These receipts represent the premium payment for the first three months of coverage which began September 19, 2008. All Treasury Guarantee Program participation payments received are invested in U.S. government securities. Applications representing at least $3 trillion of money market assets under management were received before the program application deadline. Eligibility for inclusion in the Treasury Guarantee Program was determined for those Funds that have a policy of maintaining a stable net asset value or share price that is greater than, or equal to 100.00 percent of SSP and had such policy on September 19, 2008. Funds with a net asset value below 99.50 percent of SSP as of the close of business on September 19, 2008 were not eligible to participate in the program. Of the total $337.8 million collected through the Treasury Guarantee Program application deadline date of October 10, 2008, $45.0 million was recognized as earned revenue as

NOTE 7 – TEMPORARY GUARANTEE PROGRAM FOR MONEY MARKET FUNDS (CONTINUED)

of September 30, 2008, while $292.8 million was reported as deferred insurance premium.

NOTE 8 – COMMITMENTS AND CONTINGENCIES

A. Foreign Currency Denominated Agreements

Foreign currency denominated agreements that exist between the Treasury and foreign entities or governments provide for drawings of dollars by those entities or governments and/or drawings of foreign currencies by the Treasury. The Treasury enters into these agreements through the ESF. Any balances the ESF may hold under such agreements are held to maturity. The ESF is exposed to credit risk on foreign currency denominated agreements in the event of default by counterparties to the extent of any amounts that have been recorded in the statement of financial position. Market risk occurs as a result of fluctuations in currency exchange rates. Under these agreements, the ESF receives an agreed-upon amount in dollars upon maturity regardless of currency fluctuations. There were no foreign currency denominated agreements in existence as of September 30, 2008 and 2007.

B. Exchange Stabilization Agreement

The ESF has an Exchange Stabilization Agreement (ESA) with Mexico.

In April 1994, the Treasury signed the North American Framework Agreement, which includes the ESA with Mexico. The ESA provides for a $3 billion standing swap line. The amounts and terms (including the assured source of repayment) of any new borrowings under the North American Framework Agreement are subject to certain requirements of the agreement that specify the transactions are exchange rate neutral for the ESF and would bear interest at a then current rate referenced to U.S. Treasury bills. There were no drawings outstanding on these agreements as of September 30, 2008 and 2007. On December 10, 2008, the Treasury renewed its participation in the agreement until December 2010.

C. Temporary Guarantee Program for Money Market Funds Liability

The ESF's liability under the Treasury Guarantee Program is the difference between a SSP and the amounts available to shareholders at liquidation of a participating Money Market Fund.

ESF management has assessed the likelihood of claims related to this contingency as well as any potential resultant losses. This included gathering analytical data about the Money Market Fund industry and specifically the history of funds for which NAV has dropped below the aforementioned thresholds. Based on this assessment, management has determined that while any loss on claims could be significant, currently such amount is not quantifiable and the likelihood of claims under the Treasury Guarantee Program is deemed to be remote.

NOTE 8 – COMMITMENTS AND CONTINGENCIES (CONTINUED)

The Treasury is not aware of any guarantee events which have occurred in those funds that have been accepted into the Treasury Guarantee Program. Pursuant to SFAS No. 5, *Accounting for Contingencies*, no accrual should be made. A guarantee event would require the ESF to make a payment under the Treasury Guarantee Program.

NOTE 9 – SUBSEQUENT EVENTS

On November 19, 2008, the Treasury entered into a transaction with the Reserve Fund's U.S. Government Fund (USGF), under which the Treasury (i) executed the Guarantee Agreement which accepted the USGF into the Treasury Guarantee Program (Note 7) and (ii) signed a Letter Agreement with the USGF. The Letter Agreement addresses matters such as the USGF's sale of its portfolio of securities, the ESF's purchase of remaining securities, liquidation and other matters arising out of the USGF's decision to suspend the redemption of the USGF's shares and to liquidate the USGF. On January 15, 2009, based on the terms of the Letter Agreement, the ESF purchased approximately $3.6 billion of Government Sponsored Enterprise (GSE) securities from the USGF; which amount is the purchase price representing the amortized cost of the remaining securities, plus accrued but unpaid interest. Upon consummation of the purchase, these GSE securities were classified as held to maturity and will be reported as investment securities as of the date of purchase.